

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Stow Municipal Electric Department)

v.) D.T.E. 94-176-C

Hudson Light and Power Department)

_____)

REPLY BRIEF OF

HUDSON LIGHT AND POWER DEPARTMENT

By their Attorneys,

Paul K. Connolly, Esq.

Meabh Purcell, Esq.

LeBoeuf, Lamb, Greene & MacRae, L.L.P.

260 Franklin Street

Boston, MA 02110

Tel: (617) 439-9500

Fax: (617) 439-0341

Dated: September 14, 2000

TABLE OF CONTENTS

I. BACKGROUND 1

II. INTRODUCTION 1

III. THE DEPARTMENT MAY LAWFULLY AWARD STRANDED COSTS TO HL&PD 2

A. The SJC Clearly Held the Department's Reasoning on Stranded Costs Invalid 2

1. The SJC Held that Stranded Costs Exist 2
2. The SJC Held that the Burden is on SMED to Prove Mitigability 4
3. The SJC was Aware that the Slice Could Vary in Future Years 4
4. The 1898 Statute is Inapplicable to the Present Proceedings 5
5. A Slice of System is Not an Award of Consequential Damages 6
6. The SJC and the Department have Declared that HL&PD's Stranded Costs Can Be Collected 6
7. Conclusion 7

B. The Department has Previously Excluded Prudence from this Case 8

1. SMED Disregards the Rule of the Case 8
2. MMWEC's Acquisitions have Already Been Found Prudent 9

C. SMED Fails to Prove that HL&PD Could Effectively Mitigate Costs 10

D. The Scope of the Proceeding is Limited to Review of the Slice of System 14

E. The Slice of System is Supported by the Record and is Sufficiently Defined 16

IV. SMED'S PUBLIC POLICY ARGUMENTS HAVE NO MERIT 22

Untitled

- A. HL&PD has Addressed Each of SMED's Public Policy Arguments 22
- B. SMED's Only Goal is to Evade its Stranded Cost Obligations 22
- C. Cost Control 23
- D. Consistency with Distribution Plant Sale 24
- E. SMED's "Cost Results" Argument Defies Logic 24

V. RESPONSES TO THE HEARING OFFICERS FIVE BRIEFING QUESTIONS 25

- A. The Public Interest Factors 25
- B. Advantages and Disadvantages of the Slice 25
- C. The Best Method to Effectuate the Sale 26
- D. Short-Term Contracts 26
- E. Term of the Slice 26

VI. CONCLUSION 26

I. BACKGROUND

On September 6, 2000, Hudson Light and Power Department ("HL&PD"), Stow Municipal Electric Department ("SMED"), and the Massachusetts Municipal Wholesale Electric Company ("MMWEC") simultaneously filed their Initial Briefs with the Department of Telecommunications and Energy (the "Department").

HL&PD's Reply Brief will not answer each and every argument raised by SMED in its Initial Brief (the "SMED Brief"), particularly where the argument was anticipated in HL&PD's Initial Brief, but rather will address the fundamental issues and clarify for the Department any significant mischaracterizations of law or fact contained in SMED's Initial Brief.

II. INTRODUCTION

Competition, SMED's asserted reason for separating from HL&PD, is smoke and mirrors. SMED's desire to depart the HL&PD system is not driven by its desire to compete for lower cost power. To the contrary, SMED's sole motivation is to avoid paying for stranded costs that HL&PD incurred on behalf of the ratepayers of Hudson and Stow. All of SMED's arguments, testimony and economic analyses bear this out. SMED's own witness testified that HL&PD may even be more successful than SMED in contracting for short-term power in the open market, confirming that SMED has no realistic expectation that it can effectively compete. See Tr. Vol. 3, p. 399 (Smith). It will "save" money only if it does not have to pay stranded costs.

III. THE DEPARTMENT MAY LAWFULLY AWARD STRANDED COSTS TO HL&PD

- A. The SJC Clearly Held the Department's Reasoning on Stranded Costs Invalid

SMED has stated that "the reasons for the original department determination [denying

Page 3

Untitled

stranded cost recovery] remain proper today." SMED Br. at 10. This statement ignores the fact that the Massachusetts Supreme Judicial Court vacated the Department's findings on each and every reason given by it for stranded cost recovery and remanded the case with explicit instructions to determine whether the public interest would be served by such recovery. *Stow Municipal Electric Department v. Department of Public Utilities*, 426 Mass. 341, 352 (1997) ("SJC Opinion"). In so doing, the SJC obviously disagreed with "the reasons for the original department determination." See SMED Br. at 10. Those reasons, therefore, do not "remain proper today." See *id.*

1. The SJC Held that Stranded Costs Exist

In its Order No. 94-176, issued on February 16, 1996 (the "1996 Order"), the Department found that "HL&PD has not established that stranded costs exist." 1996 Order at 45, 47. Despite SMED's obfuscation, this finding was categorically overturned by the SJC. SJC Opinion at 349-50. In so doing, the SJC rejected the Department's reasoning *seriatim*.

First, the SJC rejected the contention that "above market costs do not equal stranded costs," 1996 Order at 45, when it held that "[s]tranded costs can include existing contractual obligations for power purchases above current market rates." SJC Opinion at 348.

Second, the SJC rejected the Department's finding that "HL&PD did not adequately demonstrate why the 24-year period would be appropriate to a stranded cost calculation" and its statement that "the market price proxy is problematic." 1996 Order at 45. Instead, the SJC held the following.

The Department reject[ed] both the twenty-four year time period and the market price proxy without adequate explanation. There is evidence in the record supporting the conclusion that Hudson's contract commitments will endure for twenty-four years -- that is, that Hudson will have to pay the above-market PSA prices for twenty-four years As to the market price proxy, the department fails to explain why an arm's-length negotiation between a willing buyer and a willing seller would not approximate a fair market price.

SJC Opinion at 350. The SJC held that "[t]he Department's rejection of the twenty-four year period and the market price proxy without adequate explanation therefore was an error of law." *Id.* at 351 (emphasis added).

Third, the SJC rejected the Department's misapprehension of "strandedness." The Department had held in its 1996 Order that costs were not stranded if they could be recovered from HL&PD's remaining customers. "[I]n order to establish that costs are stranded, it must be demonstrated that they would not be recovered." 1996 Order at 45. The SJC branded this as "the most serious flaw in the Department's analysis." SJC Opinion at 351. Instead, the Court reaffirmed that stranded costs exist and drew attention to the fact that "Hudson's ratepayers will still pay higher rates with Stow's departure from the system than if Stow were to remain. This is a violation of the principle that no class of customers should benefit at another's expense." *Id.*

Fourth, the SJC rejected the Department's reasoning that because HL&PD "will need to acquire additional resources in the near term regardless of Stow's departure," 1996 Order at 46, there are no stranded costs. The SJC clearly stated that "[t]he Department's apparent reasoning that a lack of stranded megawatts translates to a lack of stranded dollars is erroneous Neither the lack of excess capacity nor the existence of an increasing load, negates the conclusion that stranded costs exist. Rather, if capacity released by a departing customer remains unsold or may only be sold at a lower price, stranded costs do exist." SJC Opinion at 349 (emphasis added).

In light of the foregoing, it is incontrovertible that the SJC clearly overruled much of the Department's reasoning as error. "The Department's order recites a number of principles associated with the recovery of stranded costs As to both

Untitled

the existence and mitigation of stranded costs, the Department failed to apply these principles." SJC Opinion at 349 (emphasis added). Regardless of SMED's continued obfuscation with respect to the state of this case, the SJC opinion - not the 1996 Order - controls these proceedings on remand, and may not be ignored.

2. The SJC Held that the Burden is on SMED to Prove Mitigability

The Department did not award stranded costs in part because it found that "HL&PD has not made a showing that it has taken all available and reasonable means to mitigate." 1996 Order at 47. The SJC likewise rejected this reasoning. "The Department found that Hudson failed to establish that it had taken and will take all available and reasonable means to mitigate stranded costs. We have held that the burden is on the party that must otherwise pay, in this case, SMED, to prove that costs could be mitigated." SJC Opinion at 351-352.

The SJC also held that the Department "required Hudson to make mitigation efforts that were futile." Id. at 352. These included "negotiat[ing] a stranded cost payment with Stow" and "renegotiat[ing] its PSAs." Id. The Court soundly rejected these requirements as improper. "We have never required a party to go through futile motions to prove nonmitigability of damages, and in our view, the Department's requiring Hudson to do so was error." Id.

3. The SJC was Aware that the Slice Could Vary in Future Years

SMED also argues that the Slice proposal violates G.L. c. 164, § 43 because it is an "open ended, almost permanent arrangement," SMED Br. at 28, and because it constitutes an "open-ended price term." SMED Br. at 29. The problem is that the SJC disagreed with this statement. SJC Opinion at 350. Aware that a Slice would extend over a term of years, and that the resources in the Slice could change, the Justices nonetheless instructed the Department to determine whether it was in the public interest under G.L. c. 164, § 43 to require SMED to take a Slice. Id. at 350. In fact, the SJC endorsed the concept of the Slice as a relatively routine arrangement in the utility world. Id. at n. 4. All of SMED's points, therefore, are moot.

4. The 1898 Statute is Inapplicable to the Present Proceedings

In asserting that "it is beyond the Department's authority to order Stow to accept any 'Slice' of HL&PD's system," SMED Br. at 19, SMED relies on a statute that the Department and SJC have both clearly ruled is inapplicable. 1996 Order at 10, 18; SJC Opinion at 350. St. 1898, c. 143, § 2 (the "1898 Statute") does not govern the determination of the property that may be included in the sale to Stow. Rather, G.L. c. 164, §§ 42 and 43 ("Sections 42 and 43") are applicable.

In the 1996 Order, the Department held that Sections 42 and 43 govern the property to be purchased by SMED. The Department stated that since "[t]he [1898 Statute] contains a reference to limited and particular provisions of another statute . . . the [1898 Statute] is a statute of specific reference." 1996 Order at 10. For that reason, the Department concluded, "the referencing language in St. 1898, c. 143, § 2 must be read to mean that the law is as St. 1891, c. 370 currently reads . . . The current version of St. 1891, c. 370, §§ 12-14 is codified at G.L. c. 164, §§ 42 and 43. Thus, Sections 42 and 43 are controlling." Id (emphasis added). Again at page 18 of the 1996 Order, the Department clearly holds that "Sections 42 and 43 govern the terms and procedure of this purchase." Therefore, the Department must interpret the meaning of the term 'property' as used in Section 43.

In its opinion reversing the Department's denial of stranded cost recovery, the SJC held that Section 43 governed the determination of property to be included in the purchase. "As we read § 43, the Department may award a utility stranded costs associated with a customer's departure when it is in the public interest to do so." SJC Opinion at 350. Accordingly, SMED's appeal to the 1898 Statute has been twice precluded, and its attempt to disregard the SJC's controlling opinion should likewise be rejected.

5. A Slice of System is Not an Award of Consequential Damages

SMED argues that Sections 42 and 43 "preclude the awarding of consequential damages. . . ." SMED Br. at 20. Again, SMED tries to circumvent the SJC's ruling. The Court denied HL&PD recovery of consequential damages "for reduced utilization of certain equipment that had been used to serve Stow", but remanded the case to the Department on recovery of stranded costs. SJC Opinion at 348 (emphasis added). SMED's discussion of consequential damages is simply irrelevant because whether the costs are labeled "stranded costs" or "damages," the Court instructed the Department to review HL&PD's right to recover a fair share of its stranded investment from SMED under G.L. c. 164, § 43. Requiring SMED to take a share in the long term power output contracts that were entered into for the benefit of Stow's ratepayers does not involve equipment and is not an award of consequential damages.

6. The SJC and the Department have Declared that HL&PD's Stranded Costs Can Be Collected

SMED argues that HL&PD's stranded costs are not stranded due to industry restructuring, which SMED asserts is a required element for recovery; therefore, SMED argues, HL&PD cannot recover its stranded costs. SMED Br. at 18. The issue of whether HL&PD can recover its stranded costs has already been decided by the Department and the SJC. Both the Department and the SJC have declared that if SMED leaves the system, the resulting stranded costs can be recovered from it.

. . . The Department finds that, consistent with the requirement of Section 43 that it consider the public interest in determining what property ought to be included in the purchase, the Department has the legal authority to base its determination, in part, upon a consideration of established restructuring principles on the recovery of stranded costs

1996 Order at 43, citing DPU 95-30 at 31-37. The Department went on to state:

Although the option to municipalize under § 43 has been available for approximately 90 years, it is clearly the current situation in the electric industry that is driving its [SMED's] petition.

Id. at 43-44. The Supreme Judicial Court confirmed the ability of the Department to award stranded costs in this case:

. . . As we read § 43 the Department may award a utility stranded costs when it is in the public interest to do so.

SJC Opinion at 350. SMED's argument must be rejected.

7. Conclusion

Therefore, despite SMED's protestations to the contrary, the Department is empowered to award stranded costs to HL&PD, and may do so by requiring SMED to take a slice of the HL&PD system. This Slice of system would be comprised of the portion of the HL&PD power supply portfolio which serves Stow. SJC Opinion at 350, n. 4. Thus, SMED's attempt to convince the Department that it cannot lawfully award stranded costs by requiring SMED to take a Slice of system is entirely without foundation.

H. The Department has Previously Excluded Prudence from this Case

1 SMED Disregards the Rule of the Case

Untitled

As it did in its Motion for Summary Disposition filed with the Department on April 18, 2000, SMED once again dismisses controlling authority and the law of the case, and instead seeks to re-argue issues that SMED waived on appeal. SMED now argues that "HL&PD has led the department into error by persuading the department to strike SMED's affirmative evidentiary demonstration that HL&PD's stranded costs were, in large part, imprudently incurred and by persuading the department to exclude HL&PD's prudence as an issue from this case." SMED Br. at 13.

SMED tacitly acknowledges that the Department has ruled adversely to it on this issue. See SMED Br. at 13. In a ruling dated August 10, 1995 ("Ruling"), Hearing Officer Alicia C. Matthews found "that the prudence of HL&PD's supply acquisitions and portfolio is not relevant to the present proceeding given that the Department lacks the authority to evaluate the prudence of municipal light plant supply acquisitions and that the prudence concept has no application in the municipal context." Ruling at 6. She therefore ordered stricken "the portions of the rebuttal testimony which relate to prudence issues . . ." Id. at 7. SMED failed to appeal this ruling to the Commission as it was entitled to do under 220 C.M.R. § 106(6)(d)(3). Accordingly, the SJC was not required to entertain it on appeal. *Lynn Teachers Union, Local 1037 v. Massachusetts Commission Against Discrimination*, 406 Mass. 515, 519, 549 N.E.2d 97 (1990) (where one defendant failed to appeal hearing commissioner's ruling to full commission, SJC would not review officer's ruling on appeal).

In any case, SMED failed to raise the issue of prudence to the SJC, and it is precluded from raising the issue now. *Boston Housing Authority v. Guirola*, 410 Mass. 820, 827, 575 N.E.2d 1100 (1991) (failure to raise or brief an issue on appeal is equivalent to waiver of the claimed error); *Barclay v. DeVeau*, 384 Mass. 676, 683, 429 N.E.2d 323, 327 (1981) ("The defendant has failed to argue on appeal any error on this issue. We therefore deem any claim of error to be waived.").

Similar to its "trumping" argument, which was also rejected by both the Department and the SJC, SMED's prudence argument has been expressly excluded and then waived on appeal only to improperly reappear in these limited remand proceedings. The Department squarely addressed this issue five years ago, after SMED was afforded a full opportunity to argue its position. The Department firmly rejected SMED's prudence argument and that ruling, as the law of the case, must stand.

2. MMWEC's Acquisitions have Already Been Found Prudent

As MMWEC explained in detail in its initial brief in this case, even if SMED were not precluded from raising prudence because of the Hearing Officer's August 1995 Ruling, MMWEC's acquisition of its project facilities and the financings undertaken for purposes of such acquisitions have already been found to be prudent by the Department. See MMWEC Br. at 21-23; 4, n. 3. In each of the financings associated with the six projects that HL&PD participates in with MMWEC, the Department issued its approvals prior to MMWEC issuing the bonds. See *id.*

Moreover, when the going gets tough, SMED cannot conveniently choose to walk away from its own actions and cry "imprudence" years later. The Selectmen of the town of Stow affirmatively voted to support the Seabrook Project No. 6. See Exh. H-10 (D.P.U. 94-176). Now SMED wants to abandon the costs of that project and force HL&PD's ratepayers to pick them up.

C. SMED Fails to Prove that HL&PD Could Effectively Mitigate Costs

Although SMED attacks the Slice of system proposal on the grounds that "it includes no mitigation by HL&PD," SMED Br. at 20, its argument is insufficient and fails to meet the burden placed on SMED by the SJC. SMED also completely disregards the significant efforts HL&PD has taken since 1991 to mitigate its stranded costs. Moreover, SMED's "reverse mitigation" arguments are without merit and should be rejected.

The SJC held that SMED must prove that HL&PD's stranded costs could be mitigated.

Untitled

"We have held that the burden is on the party that must otherwise pay, in this case, Stow, to prove that costs could be mitigated." SJC Opinion at 352. SMED utterly fails to identify a single specific method of mitigation, let alone prove its feasibility. Instead, SMED decries what it calls "reverse mitigation," and claims that "HL&PD can not [sic] demonstrate any tangible benefits of its mitigation attempts in the past" SMED Br. at 22. This line of argument overlooks the fact that the SJC placed the burden of proof squarely on SMED. "We have never required a party to go through futile motions to prove nonmitigability of damages, and in our view, the department's requiring Hudson to do so was error." SJC Opinion at 352.

SMED entirely dismisses as "reverse mitigation" the many steps taken by HL&PD since October 1991 to mitigate its stranded costs. See Exh. RH-6. As explained in detail in Exhibit RH-6, HL&PD, either on its own behalf, or through joint efforts with other entities, including MMWEC, has engaged in negotiation and/or litigation, resulting in the termination of many of its contracts and corresponding reductions in overall costs. Maine Yankee, for example was terminated when the unit was shut down by its joint owners and HL&PD successfully settled with the joint owners to buy out of the remaining part of the contract. *Id.* Negotiations regarding Vermont Yankee are ongoing. See *id.* Through MMWEC, HL&PD also availed itself of an opportunity to buy out of the PPA with RFA when the unit needed major environmental upgrades. *Id.* Furthermore, the RFA plant, Seabrook Project No. 6 and the Millstone 3 contracts are the only instances where HL&PD mitigation efforts are tied to MMWEC. HL&PD also separately bought out of the Pilgrim contract after the Pilgrim plant was sold to Entergy. Tr. Vol. 1, pp. 16-17 (Monteiro). In addition, separately from MMWEC, HL&PD mitigated its nuclear power decommissioning costs. See Exh. RH-6. Another significant mitigation measure HL&PD employed that SMED overlooks is the \$284,000 payment HL&PD made from the Rate Stabilization Trust Fund so that its customers would not be subjected to the full impact of MMWEC's acceleration due to the Pathways to Competition program.

HL&PD is mystified by SMED's allegation that "HL&PD and MMWEC together improperly refused to disclose the details" of their accelerated debt service payments. See SMED Br. at 21, citing, SMED-1-18 and SMED-1-19. The details of MMWEC's Pathways to Competition are provided in Exhibit RH-6 (supplemental). Through Pathways to Competition, MMWEC undertook the amendment of its General Bond Resolution in order to alter the timing of the Participant's debt service payment obligations. *Id.* The Amendment enabled MMWEC to accelerate the debt service billings to Participants under the PSAs so that the Participants could better compete on the open market. See *id.* As explained in Exh. RH-6 (Supp.), MMWEC has now ceased to collect any funds, and HL&PD addresses its stranded investment through its Rate Stabilization Trust Fund.

In short, none of SMED's "reverse mitigation" arguments makes any sense. Contrary to SMED's statement, HL&PD is not overearning by charging high rates. SMED Br. at 22. HL&PD's rates are in the mid-range among municipal utilities in the Commonwealth. Tr. Vol. 3, p. 199 (Monteiro). By statute, HL&PD has the right to earn a return of 8%. M.G.L. c. 164 § 58. Over the last 12 years, however, HL&PD has never earned 8%, and over the average of that period is well below 8% even taking its litigation settlements into account. Tr. Vol. 3, pp. 270-271 (Monteiro). These funds can be used for any legitimate purpose. HL&PD has elected to use its retained earnings to fund its Rate Stabilization Trust Fund in order to mitigate the shifts in market prices so that all its ratepayers, including those in Stow, are not adversely affected. See Tr. Vol. 3, pp. 184-186 (Monteiro). The use of such funds for mitigation purposes was approved by the Department in the 1996 Order at 48. The Rate Stabilization Trust and HL&PD's offer to extend the benefits to SMED is fair, and has been unfairly distorted by SMED.

SMED's hyperbole, scattered throughout its briefs, casts a sinister light on the Rate Stabilization Trust Fund. See e.g., SMED Br. at 22 ("segregating cash" beyond the Department's reach) and at 40 ("alienating" earnings from HL&PD; "bleeding" of retained earnings). SMED's apparent concern is that HL&PD will take the benefits of the Trust Fund and not share any of the funds with SMED. The evidence is uncontroverted, however, that HL&PD intends to share the Trust Fund with SMED as it

Untitled

had proposed to do in the initial proceeding. D.P.U. 94-176, p. 48. Mr. Monteiro stated:

A. Our intention is that at the point of separation that we would freeze the rate stabilization trust at that level as far as future contributions are concerned. Because we expect that Hudson is going to continue to make contributions to that over time to increase its level so that it can offset our stranded investment that is above where we stand today.

And what we were looking at is that at the point of separation we would freeze the fund and we would each draw from that fund associated with those long-term contracts that are associated with Slice of system. After that date any additional funds that we set aside for future mitigation of above-market costs would be derived solely from the Hudson ratepayers or from Hudson assets from retained earnings and would be applied only to the Hudson ratepayers. So we would have a bifurcated fund at the time of transfer so that each gets their percentage of the fund that was in place at the time we were one system but any increase above that level would be a separate chunk that would only be allocated to the Hudson segment.

Q. So the pre-separation would still be allocated and any post-separation would be left purely at Hudson's discretion?

A. Yes.

Tr. Vol. 3, pp. 257-258 (Monteiro). Mr. Monteiro also testified that the trust instrument could be modified to assure SMED would receive its share as part of the Slice of system. Id. at 278.

As another example of "reverse mitigation", SMED erroneously states that HL&PD "has accelerated book and rate depreciation on its nuclear plant investments." See SMED Br. at 21-22. The depreciation of 3% of gross plant authorized by M.G.L. c. 164 § 57 mathematically results in an annual depreciation rate for Seabrook of 10.491% of net plant. See Tr. Vol. 1, p. 49 (Monteiro). What SMED fails to understand is that HL&PD's rates would be the same whether or not it applied a 10.491% depreciation rate to its nuclear plants, or a 20% depreciation rate, provided its gross plant is depreciated at 3%. Moreover, SMED also disregards the fact that the Department suggested accelerated depreciation of an asset as a possible mitigation measure that was open to HL&PD to reduce its stranded investment. 1996 Order at 44.

Thus, as Mr. Monteiro testified, HL&PD has exhausted its mitigation options:

Q. Next question or issue that's raised, has Hudson failed to exercise a contractual right to terminate a PSA? Do you believe there's any rock unturned that you haven't looked under to try to terminate a contract if you thought it was above market?

A. No. We've looked at the termination language in all of the PSAs and PPAs, found no way that we can terminate them. We in fact beyond that, because of contractual impacts of occurrences at MMWEC or related to Project 6, have filed cases to get out of the Project 6 PSA because of MMWEC's dealing away the sell-back option, which was a prime component of that PSA.

And we as a second event, the Vermont utilities that were part of that project were able to leave that project through a - because legally they never had the right to be in the contract, so their contracts were void ab initio. We went to the SJC to see if we could also get out of the contract because of the step-up imposed by that situation, and in both of those cases the SJC upheld the contracts.

Tr. Vol. 1, pp. 17-18 (Monteiro) (emphasis added).

D. The Scope of the Proceeding is Limited to Review of the Slice of System

SMED statement that "HL&PD has introduced no evidence of the reasonability of

Untitled

HL&PD's stranded costs" is irrelevant, because the amount of stranded costs is outside the scope of this phase of the remand proceeding. See SMED Br. at 14. In the June 26, 2000 Ruling on the Scope of the Remand proceeding, the Hearing Officer stated that the scope of this phase of the case is limited to establishing what portion of HL&PD's power supply portfolio, i.e., Slice of the System, should be included in the sale to SMED, and whether HL&PD's generation units in Hudson should be included in the Slice and at what price. See H.O. Ruling, pp. 5-6 (June 26, 2000). Accordingly, the amount of stranded costs, i.e., the damages to be awarded to HL&PD for its above market costs, are not at issue in this phase. If the Department determines that HL&PD's stranded costs should be calculated, it will be necessary to perform a study, retain an expert witness and reopen the hearings. At that time, SMED and the Department will have an opportunity to review the study and assess the reasonableness of HL&PD's stranded costs.

As SMED is aware, the information provided in Exh. RH-4 is not an analysis of HL&PD's stranded costs and, therefore, should not be used as a basis for comparing HL&PD's stranded costs with Boston Edison's or any other utility. Mr. Monteiro emphasized this point during the hearings:

Q. Just so the record is clear, what you're calling the above-market price is the difference between contract price on the one hand and market price on the other. That's what you're calling stranded costs. Is that correct?

A. That's correct. And in fact, that is one of the reasons that the numbers you see in this spreadsheet are higher than the numbers that were provided in the earlier study. We are using market-clearing prices as a base for determining the stranded investment in this spreadsheet. Those prices were a quick set of numbers we received from MMWEC and were used to give a benchmark as to what a fixed number of stranded investment might be in today's world versus at the hearing several years ago.

To get a realistic or a more current analysis done, it would take more time than we had available to us in preparation of these hearings. And so this was provided just as a benchmark and doesn't necessarily give the full picture of what a fixed stranded investment number might be.

Tr. Vol. 1, pp. 39-40 (Monteiro) (emphasis added). Thus, there is no evidence of the exact amount of HL&PD's stranded costs on the record and therefore no basis for SMED's allegation that the costs are "grotesquely large". SMED Br. at 14. In fact, HL&PD is at the median for all municipal utilities in Massachusetts, and its overall rates and power supply costs are competitive with all utilities. Tr. Vol. 3, p. 199 (Monteiro). Its power supply costs therefore cannot be "grotesque."

The analysis in Exh. RH-4 was intended to indicate the order of magnitude of HL&PD's potential stranded costs and to show the parameters that would need to be considered in a full-blown stranded cost study. Tr. Vol. 3, pp. 39-40 (Monteiro); See also Exh. RH-4. HL&PD's modification of RH-4 that resulted in a lower stranded cost figure of approximately \$9 million, was not to "reverse its course," but to demonstrate how the stranded cost number would change depending upon the assumptions used. See SMED Br. at 14-15.

Notwithstanding the fact that the amount of HL&PD's stranded costs is outside the scope of this phase, SMED's assertions concerning the "reasonability" of the costs are erroneous. See SMED Br. at 14-17. For example, SMED's comparison to Boston Edison Company's ("BECO") stranded costs is misleading and not probative of anything except that different utilities have different stranded costs. There is no evidence of the assumptions used in the calculation of BECO's stranded costs, e.g., the discount rate, the market price of power or escalation rates used in the calculation. HL&PD's revision of its Exhibit RH-4 by changing the assumptions shows how different assumptions can affect a company's stranded costs. SMED's analogy is overly simplistic and should be rejected. Interestingly, SMED only offered BECO as a comparison utility rather than Commonwealth Electric Company with proportionally larger stranded costs that it was permitted to recover. See Cambridge Elec. Light Co., Commonwealth Elec. Co., and Canal Elec. Co., D.P.U./D.T.E. 97-111 (Feb. 27,

1998).

E. The Slice of System is Supported by the Record and is Sufficiently Defined

SMED's argument that the Department cannot order a Slice of system because the Slice is "ill-defined" and "vague" is plainly wrong. SMED Br. at 23-25. Putting aside the fact that Mr. Monteiro provided extensive oral testimony describing the Slice and explaining precisely how it would be implemented, the SJC ordered the Department to consider whether it would be in the public interest to require SMED to take a Slice if it departs the HL&PD system. SJC Opinion at 350. The Court clearly found the record evidence on the Slice of system to be sufficient, and it clearly understood the Slice concept when it ruled:

The Department treated Hudson's request to have Stow buy a "Slice of system" as a request to assign to Stow portions of the PSAs themselves. The record does not support the Department's characterization. Hudson wanted the Department to include a portion of the power in the sale of property to Stow. There is no evidence that this would require an assignment of the contracts. The Department has never treated a Slice of system as it did in this case. See Fitchburg Gas & Elec. Light Co., D.P.U. 89-153 (1989). There was no basis for the Department's assertion that Hudson wanted to assign Stow portions of the PSAs. On remand, the Department should consider whether the public interest favors including in the property to be sold to Stow a portion of the power that Hudson purchases under the PSAs.

SJC Opinion at 350.

Moreover, as Mr. Monteiro explained, a Slice of system is a recognized arrangement in the utility industry and requires little explanation. Tr. Vol. 1, p. 41 (Monteiro). Indeed, the SJC acknowledged as much when it said "[a] Slice of system is an arrangement under which a utility sells a mix of resources from its portfolio, rather than all of the output from only one facility". Id. at 350, n. 4. Thus, no further "definition" of the Slice is needed.

HL&PD responds to SMED's 14 specific criticisms of the Slice proposal as follows:

1. SMED: How is the percentage that determines that "width" of the "slice" in each year to be determined?

HL&PD: As explained in its initial brief, HL&PD has agreed to fix the Slice at 12.9% to meet SMED concerns. See HL&PD Br. at 10. The "width" of the Slice, therefore, is irrelevant.

2. SMED: If the "width" of the slice is based on energy, is that measured before or after losses?

HL&PD: The line losses within Stow are not included in the Slice when it is based upon the proposed fixed energy ratio of 12.9% for 1999. Inclusion of line losses would increase the ratio.

3. SMED: If the "width" of the slice is based on load, is that measured by Stow's non-coincident peak (NCP) load, or by Stow's contribution to the Stow plus Hudson coincident peak (CP) load?

HL&PD: Again, to take into account SMED's concerns, the proposed Slice is not based upon load but upon a fixed energy ratio for 1999. See HL&PD Br. at 9-10.

4. SMED: How are the other towns served by HL&PD to be counted? Are their energy or loads to be in the numerator, or the denominator, or both?

HL&PD: SMED's proportionate share of the Slice is based upon the 1999 energy consumption by customers in Stow alone. Customers in other towns that will be served by SMED should have been included but were not. If they were included, SMED's proportionate share of the Slice would increase.

Untitled

5. SMED: Who bids the Cherry Street units into the ISO?

HL&PD: SMED has raised this issue for the first time on Brief. See SMED Br. at 24. The Department knows, however, that a Slice does not convey ownership interests. HL&PD, as the owner of the facility, is the entity that bids Cherry Street into the ISO generation market. Hudson will of course continue to own Cherry Street and bid it into the ISO in accordance with the New England Power Pool Market Rules and Procedures Nos. 1 (defines lead participant) and 3 (description of market bids); See also, Tr. Vol. 1, p. 100-101 (Monteiro).

6. SMED: What is the duration in years of the "slice" for each unit?

HL&PD: The duration in years of each unit in the Slice has been amended to take SMED's concerns into account. See HL&PD Br. at 10. HL&PD has offered to commit to ending the Slice of system at the earlier date(s) associated with the payoff of the bonds for the MMWEC PSAs as a specific termination point and/or the earliest termination date for Cleary Nine. For the directly-owned units, the Slice ends when the units are depreciated. Tr. Vol. 1, pp. 118-119 (Monteiro); Tr. Vol. 3, pp. 196-197 (Monteiro). At that point in time, without the bond payments or depreciation, the cost of power from the PSAs would be competitive and as a result HL&PD would give SMED the option to extend the Slice of system to the life of the unit or avail itself of life extensions, if any. HL&PD would also extend to SMED the option to continue taking power from the directly-owned units beyond the dates on which they are fully depreciated.

7. SMED: Are routine capital additions, rebuilding of entire units due to catastrophic losses, repowerings, or life extensions of units included?

HL&PD: SMED has introduced for the first time on Brief the issue of routine capital additions and catastrophic loss requiring the rebuilding of a unit(s). See SMED Br. at 24. It is a non-issue, as all the units in the MMWEC PSAs carry insurance to cover the cost of recovery from catastrophic failures, which will limit any obligation to HL&PD as net of insurance. The issue of routine capital expenditures is also raised for the first time but these expenditures are clearly part of the cost of the Slice of system and will be passed through in the fixed cost portion of the Slice billing.

The response to (6) above addresses how HL&PD will accommodate SMED's concerns regarding life extension. The issue of repowering varies from unit to unit in the Slice. The MMWEC PSAs for Seabrook and Millstone 3 and the HL&PD Seabrook direct ownership are limited by the ability of the joint owners to obtain an NRC license extension. In the case of Seabrook, the current operating license expires in 2026 as indicated in Exh. RH-2. Docket No. 50-443 License No. NPF-86; See also, Tr. Vol. 3, pp. 232-233 (Monteiro). Seabrook's lead owner/operator at that time will be operating the unit in the deregulated generation market, so any license extension would mean the unit is competitive with market prices at that time. However, SMED does not have to participate. Its obligation will end when the MMWEC bonds are paid off in 2019.

8. SMED: Who votes HL&PD's ownership shares in units covered by joint ownership agreements?

HL&PD: This issue was also not raised during the hearings. HL&PD votes only its direct ownership share in Seabrook and will continue to do so for any unit covered under a joint ownership agreement. See Tr. Vol. 3, pp. 231-234 (Monteiro).

9. SMED: How are extensions (by refinancing) to bond terms by MMWEC, if any, handled?

HL&PD: Mr. Monteiro responded to this issue during the hearings and explained that HL&PD's obligations will end when the bonds are paid off, and that if SMED desires, the Slice can be coterminous with the bond payments. Tr. Vol. 3, pp. 196-97

Untitled

(Monteiro); See also Tr. Vol. 3, pp. 258-261 (Monteiro). Now, it appears that SMED is reversing its position, and prefers life of unit over life of bonds. See SMED Br. at 47. If the life of the present bonds is determined by the Department as the appropriate end dates of SMED's obligation for the Slice of system, then SMED would be unaffected by any extension of the bond terms by MMWEC.

10. SMED: How are disputes about billing handled?

HL&PD: Disputes would be resolved by arbitration. Tr. Vol. 3, p. 238 (Monteiro). If SMED wants disputes resolved through the court system, HL&PD would be agreeable.

11. SMED: How are excess KWHs in "valley" load times for Stow handled?

HL&PD: SMED intimates that there will be times of excess generation for Stow after separation under the Slice of system. See Tr. Vol. 4, pp. 379-380 (Smith) As explained in HL&PD's Initial Brief, using the 1999 energy ratio as the allocator, SMED will not have excess KWHs. HL&PD Br. at 6-7; Tr. Vol. 3, pp. 198-199 (Monteiro). This is confirmed by SMED Record Response. RR-H-1. Moreover, if there were excess capacity it would be absorbed by the Independent System Operation ("ISO") and paid for at market clearing price.

12. SMED: Who makes dispatch decisions, say for Cherry Street?

HL&PD: SMED raises this issue for the first time on Brief, and again tries to make a mountain out of a phantom molehill. HL&PD is the owner of Cherry Street and will continue to bid it into the ISO who will make dispatch decisions based on any bid in comparison to market clearing price, among other factors. The designated lead owners of the other facilities in the Slice will similarly make bids for their own units and the ISO will dispatch them as it does other units. Like other generation plant operators, HL&PD may occasionally be required to self-schedule Cherry Street to meet its operational needs.

13. SMED: Who makes retirement decisions, say for Cherry Street?

HL&PD: Once more, SMED did not raise this as an issue during the hearings. Retirement of any unit is a decision for the owner(s) of the resource. In the case of Cherry Street, the HL&PD Light Board would determine when the facility or any one of its several units should be retired. However, SMED's obligation to the Slice of system power related to this plant would end when the plant is fully depreciated, although SMED could request an extension if the plant continues to operate past that point in time. Like all of HL&PD's customers, SMED has always been welcome to attend Light Board meetings. Thus, SMED will have an opportunity at future Light Board meetings to have input into any decision whether to retire Cherry Street.

14. SMED: What adjustments, if any, are made for the fact that Hudson's and Stow's load shapes differ?

HL&PD: The issue of load shape is not an issue since HL&PD has agreed to use a fixed energy allocator based upon 1999 usage.

XV. SMED'S PUBLIC POLICY ARGUMENTS HAVE NO MERIT

1 HL&PD has Addressed Each of SMED's Public Policy Arguments

In Section IV of its Brief, SMED reiterates all of its old arguments and recasts them as "public policy" reasons why the Department should not include a Slice of system in the sale. See SMED Br. at 31-34. HL&PD has addressed Imprudence at Section III B, supra, Unreasonability at III D, supra, Costs Stranded for Reasons Unrelated to Restructuring at III A 6, supra, Generation Plant outside Stow at III A 4, supra, Consequential Damages at III A 5, supra, Mitigation at III A 2 and III C, supra, Lack of Definition at III A 3 and III E, supra, Alma Ruling in HL&PD Initial Br. at 19-23, and SMED's Right to Sell, Right to a Determined Price and Right to Determination of Property at III B 3, supra.

Untitled

B. SMED's Only Goal is to Evade its Stranded Cost Obligations

In this Section, SMED also proffers a weak argument that the Slice would be contrary to public policy because it would "destroy SMED's ability to compete as an independent entity in the open market." SMED Br. at 34. As explained earlier, SMED has no real wish to compete. Section II, *supra*. Ms. Smith acknowledged that SMED would probably not do any better on the short term market than HL&PD. Tr. Vol. 3, p. 399 (Smith). Why then, would SMED be so anxious to leave the HL&PD system? The answer is obvious -- to avoid paying the fair share of HL&PD's stranded investment that was incurred on its behalf. This has been its sole motivation from the beginning, as all of its arguments bear out. At every turn, SMED either ignores or turns the SJC's decision on its head and argues that no stranded cost recovery should be awarded to HL&PD. SMED even argues that HL&PD should pay SMED stranded costs as "compensation" for the fact that SMED would receive none of the benefits of HL&PD's accelerated depreciation of Seabrook. Exh. RS-2, at 6. SMED also argues that the Department should base the Slice on a "reasonable expectation" period of 10 years starting in 1986. See SMED Br. at 45. It makes this argument so that SMED will not pay a dime of stranded costs. SMED also argues that it has already been paying for a "slice" since 1994 when it voted to separate by continuing to pay down the costs in the intervening years. *Id.* at 15. Thus, SMED is merely using the trend towards competition as a convenient excuse to evade its obligations.

C. Cost Control

SMED's argument that the Slice shields HL&PD from the disastrous effects of its "bad decision-making" is simply a rephrasing of its "imprudence" argument, with some additional rhetoric. See SMED Br. at 35-36. SMED participated in and endorsed the "bad decision" in 1984 when the Stow selectmen voted to support the Seabrook project as being the most logical and economical means of meeting this demand and its keeping electric rates as low as possible. See Exhibit H-10 (D.P.U. 94-176). As explained at length by MMWEC, the Department reviewed all of MMWEC's financings that preceded the various projects and clearly found that MMWEC's and the Participant's decisions were appropriate and reasonable at the time they were made. It is bad public policy to retroactively determine that embarking on these projects was a "bad" decision with "disastrous" results.

Similarly, SMED's cost causation argument that HL&PD "went on a bizarre buying spree and should bear all of the stranded costs" is contrary to the fact that its power supply costs are not out of line with other municipal utilities. Contrast SMED Br. at 36 with SJC Opinion at 351; see also Tr. Vol. 3, p. 199 (Monteiro). The Court explicitly rejected the notion that HL&PD should bear 100% of the stranded costs on the grounds that:

It violates the principle that no class of customers should benefit at another's expense. The natural consequence of the Department's decision [to deny HL&PD recovery] is that Hudson's ratepayers will bear all of the costs under the PSAs and Stow ratepayers will bear none.

SJC Opinion at 351.

D. Consistency with Distribution Plant Sale

Again, SMED argues that the Slice is "inconsistent" with the Department's previous ruling that the sale should be a 50/50 weighting of OCLD and RCNLD. SMED Br. at 37. The Court knew this when it endorsed the Slice and remanded the case to the Department for further determination. In fact, the Court affirmed the 50/50 OCLD and RCNLD weighting for the distribution plant, recognizing that stranded power supply costs required separate treatment under c. 164, § 43. SMED cannot be allowed to disregard the Court's decision. The Department has also treated stranded investment separately from the acquisition of distribution facilities in restructuring. See St. 1997, ch. 164, § 196 (G.L. c. 164, § 34A).

E. SMED's "Cost Results" Argument Defies Logic

SMED's argument that "shifting dollars" from HL&PD to SMED will have a disproportionate result because the impact on Stow would be 8 times greater than on HL&PD, makes no sense. SMED Br. at 40-41. By taking one-eighth (1/8) of the power supply costs, i.e., 12.9%, the dollar impact on SMED would be the same as on HL&PD that bears the remaining seven-eighths (7/8) of the total power supply costs, i.e., approximately 87.1%. The Slice actually maintains complete parity between HL&PD and SMED and the Department should give no weight to this "public policy" issue.

VI. RESPONSES TO THE HEARING OFFICERS FIVE BRIEFING QUESTIONS

1 The Public Interest Factors

SMED raises no new issues in response to the Department's first question, and HL&PD rests on its initial brief and its responses to SMED's arguments in this Reply. See HL&PD Br. at 11-12.

B. Advantages and Disadvantages of the Slice

Many of the "disadvantages" that SMED raises have already been addressed by HL&PD. See SMED Br. at 44. HL&PD has agreed to fix the size of the Slice at 12.9%, and to allow SMED the choice of terminating the Slice when the last payment under the bonds have been paid, or continuing the Slice under any life extension options. See HL&PD Br. at 10. This accommodation should eliminate SMED's concerns about the indeterminate price, and size of the Slice in terms of KWs, KWHs and years. See SMED Br. at 44.

SMED's hyperbole about HL&PD's "imprudent, unreasonable and economically disastrous" dependence upon Seabrook requires no further discussion beyond HL&PD's responses in Sections III C and E, *supra*.

C. The Best Method to Effectuate the Sale

SMED's only point in this section is to continue its campaign of forcing HL&PD to bear a greater share of the stranded costs, in order to keep SMED's share as small as possible. See SMED Br. at 45. The problem is that the "smaller the Slice," the more HL&PD has to pick up above and beyond its share. The SJC has explicitly ruled this result unacceptable - both sets of ratepayers must share equally in the burden and one set should not be advantaged at the other's expense. SJC Opinion at 351.

D. Short-Term Contracts

SMED now apparently acknowledges the illogic of including short-term purchases in the Slice. SMED Br. at 46. But SMED continues its refrain that any Slice is "fatal" to SMED, even a Slice that includes short-term contracts as a "palliative" measure. See *id.* The "resulting inequity" to HL&PD, to borrow SMED's words, of a 10-year Slice (that started in 1986) would be a free ride for SMED.

E. Term of the Slice

SMED has changed its tune and now finds that the life of the unit is preferable to the life of the bonds, although this position contradicts its concern about the lack of definition, and indeterminate length of the Slice obligation. See SMED Br. at 47. The choice to SMED is easy - either stay in or drop out of the Slice when the bonds are paid off.

VI. CONCLUSION

For the foregoing reasons and for the reasons set forth in its Initial Brief, HL&PD

Untitled
respectfully requests that the Department order SMED to take a 12.9% Slice of
HL&PD's system fixed from 1999.

Respectfully Submitted,

HUDSON LIGHT AND POWER DEPARTMENT

By their Attorneys,

Paul K. Connolly, Esq.

Meabh Purcell, Esq.

LeBoeuf, Lamb, Greene & MacRae, L.L.P.

260 Franklin Street

Boston, MA 02110

Tel: (617) 439-9500

Fax: (617) 439-0341

Dated: September 14, 2000